

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 2506

Assembly Member Steinberg (As amended 6/29/02)

Position:

Support

Proponents:

UTLA, CTA (Sponsors), AFT College Faculty Guild Local 1521, SSDA, TIAA-CREF, ACSA, CSBA, Meridian Wealth Management

Opponents:

CFT

SUMMARY

Assembly Bill 2506 requires the California State Teachers' Retirement System (CalSTRS) to establish a registry for vendors who wish to offer tax-deferred 403(b) investment products that school districts, community college districts and county offices of education may provide to their employees. It also requires CalSTRS to publicize an impartial investment bank of information of such products through the Internet.

LEGISLATIVE HISTORY

P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), enacts a number of changes to federal law to enhance the portability of funds among different types of retirement plans, including 401(k), 403(b) and 457 plans, IRAs and 401(a) retirement plans. In addition, it increases the contribution limits to 403(b), 457 and 401(a) plans, and increases the annual allowance limit for defined benefit plans.

Chapter 291, Statutes of 1994 (AB 3064—Morrow) requires CalSTRS to offer employees of school districts, community college districts and county offices of education a 403(b) tax-deferred retirement plan.

Chapter 423, Statutes of 1972 (AB 1802—Knox) prohibits state agencies from negotiating life and disability insurance or annuities except to the extent that it has a direct financial interest. Also allows the employee to designate the agent, broker or company he or she purchases an annuity through and requires their employer to facilitate their designation.

SUMMARY OF CHANGES

Amendments to the introduced bill limit the scope of the bill to school employees instead of all public employees, and eliminate the requirement that vendors of Section 457 tax-deferred retirement plan products register with the Teachers' Retirement Board (Board). The role of school districts and community college districts is now limited to verifying that requests they

process on behalf of employees are for registered vendors. In addition, the Board is now protected from liability for the actions of registered vendors and the July 1, 2003 completion date for the initial registration process is extended to January 1, 2004.

BACKGROUND

Section 403(b) of the Internal Revenue Code (IRC) provides a means for school employees to save additional funds for retirement on a tax-deferred basis. Under such an arrangement, participants do not pay income taxes on the amount contributed or the earnings of the accounts until the funds are distributed, generally after retirement. Historically, 403(b) funds have been saved through insurance-based products, known as tax-sheltered annuities (TSAs), although federal legislation subsequently permitted the establishment of custodial accounts by which participants could invest in mutual funds. Under EGTRRA, participants can contribute up to \$11,000 in 2002 in 403(b) accounts, with that amount increasing by \$1,000 annually to \$15,000.

The CalSTRS Voluntary Investment Program (VIP) is a 403(b) program that provides a low-cost means for public school employees to invest on a tax-deferred basis to supplement their retirement. Unlike most 403(b) plans, the CalSTRS VIP is a custodial account, which permits direct investment of contributions into mutual funds. As of February 1, 2002, there were 2,822 participants in the VIP, with assets valued at over \$60 million.

At the July 11, 2002 Teachers' Retirement Board meeting, the Board approved a list of 12 core funds, plus a self-managed account, for VIP participants to invest in. VIP participants will have the opportunity to invest in an S & P 500 index fund, money market fund, international stock fund, broad market fund, small cap funds and other investment options. All funds offered by the VIP are either no-load or the load normally charged is being waived.

Under Section 770.3 of the Insurance Code, employees may designate any licensed insurance agent, broker or company with whom to invest in a TSA. As a result, individual employers may offer hundreds of different choices to employees, and undertake little evaluation or provide little information that enables employees to make informed decisions about their supplemental retirement investments. One means by which some employers limit the number of potential vendors is a requirement they impose for the potential 403(b) vendor to enter into a hold-harmless agreement with the district. The agreement limits the liability of an employer in a variety of areas, such as the failure of the employer to limit an employee's contributions in all available 403(b) options to the statutory contribution limit. In addition, the agreements often require an agent of the vendor to confirm in writing that the agent met with the participant. Because many low-cost program options, such as the VIP and other custodial accounts, do not have agents in the field, some low-cost options are not available in districts that impose such requirements.

DISCUSSION

Assembly Bill 2506:

- Requires the Board to establish by January 1, 2004, a registration process for vendors that wish to offer 403(b) retirement plan investment products to employees of school districts, community college districts and county offices of education.
- Requires the Board to register those products that provide information regarding:
 1. Investment products and distribution options
 2. Administrative, plan and reporting features
 3. Administrative costs, fees, and penalties
 4. Retirement counseling and education services
 5. Office locations and counseling service areas
 6. History and record of experience
- Requires the Board to establish and maintain a data bank of registered vendors and their retirement investment products for employers and participants that contains "objective" comparisons of participant cost and education, vendor experience and services. Requires the Board to provide information on the investment performance of each registered product, as measured by a financial rating service.
- Requires the Board to design an information bank Internet Web site and include investment product plan information and education materials taken from the Internal Revenue Service, SEC and other governmental and regulatory agencies. The Board would be prohibited from ranking or giving preference to any vendor or product on the Web site.
- Requires the Board to establish an annual open registration period and authorizes it to require vendors to renew their registration at least every five years. Allows registered vendors to add additional products at any time by registering them with the Board. Requires vendors to submit an update of required information within 60 days if the product or service offered changes between renewal periods.
- Allows vendors 60 days to correct errors in the required product information they provide to the Board. Authorizes the Board to remove vendors from the list if they submit inaccurate information or have their applicable state license or National Association of Securities Dealers membership revoked. Requires the Board to establish an appeals process for vendors denied registration or who are removed from the list.
- Requires the Board to assess vendors equally, based on the number of participating vendors, for the costs it incurs in establishing and maintaining the registration process and data bank.

- Requires the System to include information in all newsletters to members and participants regarding the investment information bank, and include the same information on CalSTRS members' and participants' annual statements.
- Authorizes school employers to allow current employees to keep their existing accounts and continue to make contributions with companies that do not become registered if the investment was made in the unregistered product prior to January 1, 2004.
- Prohibits the employer from receiving any direct or indirect consideration or compensation for the promotion of a particular vendor's product.
- Prohibits vendors from claiming that registration with the Board constitutes an endorsement by the Board or the System, and specifies that the System is not liable for the actions of registered vendors.
- Prohibits the System from diverting member services staff or resources to establish or maintain the registry.

AB 2506 establishes a registration, not a regulatory process within CalSTRS. Rather than evaluating the financial strength of individual vendors or the value of their investment options, it requires CalSTRS to compile and display specified information on registered 403(b) retirement plan products and the benefits of tax-deferred retirement plans in general. CalSTRS would develop internal documents, external publications and forms detailing the specifications for the information vendors must provide about their plans, including a description of acceptable formats (preferably electronic to ease processing and publishing), and methods of delivery. CalSTRS would also develop a process to verify that the information vendors provide is complete and undertake follow-up activities with vendors whose submittals did not meet the requirements. By allowing vendors to correct information before they are considered for removal from the list, CalSTRS would avoid most appeals proceedings and the additional staff resources they consume.

Establishing the registration process would require CalSTRS to, among other things, (1) develop a database to store the collected information, (2) identify the specific information that is required to meet the requirements the bill imposes on applicants in order to register with CalSTRS, (3) develop a standardized form that would permit potential registrants to submit the required information both on paper and electronically and (4) inform both employers and the investment community of the requirements imposed by the bill. CalSTRS would compile all the required information to produce a publication, and establish a Web site that enables school employees to obtain the requested information online.

According to the sponsors: "teachers and other school district employees that qualify to purchase TSAs through their 403(b) plans are drowning in choice. California Insurance Code 770.3 allows these employees to purchase TSAs through any provider or company of their choice. But what began as a law intended to protect employees' freedom of choice has resulted in an unwieldy

benefits system with excessive providers, administrative burdens, and ongoing liability concerns. Many teachers struggle to budget for their retirement, only to discover that undisclosed fees, penalties, and restrictions erode their savings. Companies in the private sector screen retirement products for their employees' 401(k) plans. Teachers demand a similar screening performed for 403(b) products.”

Under AB 2506, companies that offer Section 403(b) annuity plans directly to employees of school districts, community college districts and county offices of education must, for the first time, register their products with CalSTRS before credentialed and classified school employees may select their products. Providers of Section 403(b) custodial account plans must also register their products with CalSTRS to be considered by school employers. There are an estimated 1,000 403(b) plans currently on the market. The bill does not propose any changes in state law that would address issues raised by the types of hold harmless agreements required by some districts. Nevertheless, establishing a registry of 403(b) products would enable school employees to compare available products on a standardized basis, using a series of criteria, including cost, historical investment performance, and services offered. This would enable employees to make more informed choices in their investments.

FISCAL IMPACT

Benefit Program Costs – None

Administrative Costs – Staff estimates total one-time costs of \$450,000 to \$500,000 to develop the registration process, process initial enrollment by vendors and establish the database. There would be ongoing personnel and operating costs of approximately \$75,000 annually to maintain the database information, register and renew vendors.

The costs to establish the registration process and any ongoing costs would be paid from registration, maintenance and administrative fees.

BOARD POSITION

Support. This bill would provide CalSTRS members and participants and classified employees with a registry of objective information from which to evaluate and compare various 403(b) investment products.